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In The

Supreme Court of the United States

JACK EASTERDAY,

Petitioner,

vs.

UNITED STATES,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. IS FINANCIAL HARDSHIP A DEFENSE TO CIVIL AND CRIMINAL TAX PENALTIES FOR FAILURE TO PAY PAYROLL TAXES, A QUESTION ON WHICH THE CIRCUIT COURTS OF APPEAL ARE IN CONFLICT?

II. IS THERE A DEFENSE OF NECESSITY IN FEDERAL CRIMINAL CASES, AN ISSUE THAT THIS COURT HAS RECOGNIZED IS IMPORTANT BUT THUS FAR LEFT UNDECIDED?

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PETITION FOR WRIT OF CERTIORARI

Petitioner Jack Easterday respectfully prays that a Writ of Certiorari issue to review the judgment and decision of the of United States Court of Appeal for the Ninth Circuit entered on April 27, 2009.

CITATION OF OPINION BELOW

The published opinion of the United States Court of Appeal for the Ninth Circuit is reproduced at Appendix ("App.") 1-26. The official reporter citation of the opinion is *United States v. Easterday*, 564 F.3d 1004 (9th Cir. 2009).

STATEMENT OF JURISDICTION

On August 22, 2008, a divided three-judge panel of the United States Court of Appeal for the Ninth Circuit issued a published opinion affirming petitioner's criminal conviction. *United States v. Easterday,* 539 F.3d 1176 (9th Cir. 2008). Petitioner filed a timely petition for rehearing en banc. On April 27, 2009, the same panel, again by a 2-1 vote, issued an order amending the opinion and denying the petition for rehearing en banc. *United States v. Easterday,* 564 F.3d 1004 (9th Cir. 2009). The amending order is reproduced at App. 2.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254.

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Section 7202 of Title 26 of the United States Code states:

> Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $ 10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

Sections 6651 and 6656 of Title 26 of the United States Code are reproduced at App. 46-53. Section 301.6651-1 of Title 26 of the Code of Federal Regulations is reproduced at App. 54-66.

STATEMENT OF THE CASE

Petitioner Jack Easterday was convicted of failing to pay payroll taxes in violation of 26 U.S.C. § 7202. Mr. Easterday owned and operated several nursing homes in Northern California. Between 1998 and 2005, he failed to pay the full amount of payroll

taxes due. Mr. Easterday consistently filed tax returns that correctly reflected his tax liability, but during the charged period, he only paid approximately two-thirds of the amount due. As a result, he fell millions of dollars behind in his tax payments, and he was ultimately charged with over 100 criminal counts under § 7202. He was tried, convicted, and sentenced to prison for thirty months in the District Court for the Northern District of California, which had jurisdiction pursuant to 18 U.S.C. § 3231.

At trial, Mr. Easterday sought to establish that he had good cause for failing to pay the full amount due. He sought to demonstrate that his nursing homes faced extraordinarily difficult financial circumstances, and that as a result, he was forced to choose between paying the full amount of his tax liability and continuing to operate the nursing homes, which provided critical care for hundreds of sick and elderly clients. He could not afford to do both, and he sought to show that using tax funds to pay other obligations was the lesser of two evils.

Consistent with that defense of financial hardship, Mr. Easterday sought to present evidence that would have demonstrated the nursing homes' troubled finances. He also sought a jury instruction that inability to pay was a defense to criminal tax liability under § 7202.

Mr. Easterday's proffered evidence and requested jury instruction were based on the Ninth Circuit's decision in *United States v. Poll*, 521 F.2d 329 (9th

Cir. 1975). In *Poll*, the Ninth Circuit established an inability-to-pay defense in criminal cases. *Poll* held that in order to obtain a conviction under § 7202, the government "must establish beyond a reasonable doubt that at the time payment was due the taxpayer possessed sufficient funds to enable him to meet his obligation." *Id.* at 333.

Although neither this Court nor the Ninth Circuit had ever explicitly overruled *Poll*, the district court held that *Poll* was no longer binding law. *See* App. 41-45. It thus denied Mr. Easterday's request for a jury instruction on inability to pay, and it also excluded much of Mr. Easterday's evidence regarding financial distress.

Mr. Easterday timely appealed to the Ninth Circuit, which had jurisdiction under 28 U.S.C. § 1291. He argued that *Poll* remained good law, and thus that the district court had erred by rejecting his instruction and excluding his evidence. A divided panel of the Ninth Circuit affirmed his conviction. *United States v. Easterday,* 539 F.3d 1176 (9th Cir. 2008). The majority conceded that the Ninth Circuit had "not . . . explicitly overruled *Poll*." 539 F.3d at 1181. It nonetheless concluded that *Poll* was irreconcilable with this Court's ruling in *United States v. Pomponio*, 429 U.S. 10 (1976). *Id.*

Judge N. Randy Smith dissented. He argued that "*Pomponio* also did not overrule *Poll* because *Pomponio* and *Poll* address different issues." 539 F.3d at 1185 (Smith, J., dissenting). According to Judge

Smith, the judges in the majority had "chosen to write around circuit precedent in order to avoid a result that they do not like." *Id.* at 1183.

Mr. Easterday timely filed a petition for rehearing en banc. On April 27, 2009, the panel issued an order amending the opinion and denying his petition. App. 1-17; *United States v. Easterday,* 564 F.3d at 1005-1011 (9th Cir. 2009). Judge Smith once again dissented. App. 18-26; 564 F.3d at 1011-1015.

Mr. Easterday now petitions this Court for a Writ of Certiorari from the decision of the Ninth Circuit Court of Appeals.

REASONS FOR GRANTING THE WRIT

The panel below arguably violated the law by overruling prior Ninth Circuit precedent without convening an en banc panel. *See* 564 F.3d at 1012 (Smith, J., dissenting). But even setting that issue to one side, there are two reasons why this Court should grant review.

First, review is necessary to settle a complicated split of authority among the circuit courts. While the ruling below holds that ability to pay is irrelevant in criminal prosecutions under 26 U.S.C. § 7202, several circuits, including the Ninth Circuit, have ruled, and continue to hold, that inability to pay is a defense to civil tax penalties for failing to pay over payroll taxes.

Second, review is warranted to settle an important question of federal law – namely, whether in the absence of contrary direction from Congress, the common law defense of necessity exists for federal crimes. That question has never been clearly settled by this Court, and it should be now.

1. Review is Necessary to Settle a Division of Authority Regarding Whether Inability to Pay is a Defense to Civil or Criminal Penalties for Failing to Pay Payroll Taxes

In order to fund the nation's vast entitlement programs, employers are required to withhold payroll taxes from their employees. 26 U.S.C. §§ 3101, 3102. Withheld funds are held "in trust for the United States," *id.* § 7501(a),[1] and must be paid to the government in quarterly installments.

The IRS has a variety of mechanisms, both civil and criminal, to ensure that employers pay over their employees' payroll taxes. *See Slodov v. United States*, 436 U.S. 238, 243-245 (1978). First, if an employer fails to comply with its obligations, the IRS may require creation of a special, segregated bank account

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[1] As this Court has recognized, however, the § 7501 trust "is radically different from the common-law paradigm" trust, in part because the trustee is not required to segregate trust assets. *Begier v. IRS*, 496 U.S. 53, 62 (1990). Congress's primary purpose in creating the § 7501 "trust" was to give the federal government priority over other creditors in bankruptcy proceedings. *See id.* at 63-66.

for payroll taxes. 26 U.S.C. § 7512. Second, the IRS may pursue civil penalties (in the form of percentage fines) for failure to make timely payments. *Id.* §§ 6651, 6656. Third, and most seriously, the government may pursue criminal penalties for willful failure to pay. *Id.* § 7202.

Payroll trust funds are undoubtedly a "tempting source of ready cash" for corporations, especially corporations in financial distress. *Slodov*, 436 U.S. at 243. The legal question presented here is whether a showing of financial distress can ever constitute a defense to the civil or criminal penalties provided by the Internal Revenue Code. On that question, there is currently a division of authority among the circuits.

As noted above, in *Poll*, the Ninth Circuit established an inability to pay defense in criminal cases. The Sixth Circuit was the next court to address the question. In *United States v. Brewery*, 33 F.3d 589, 592 (1994), it held that because payroll taxes are held in trust, financial distress can never constitute reasonable cause for failure to pay payroll taxes. Several other circuits, however, subsequently reached a contrary result – they have held that in at least some circumstances, a showing of financial hardship may constitute a defense to the civil penalties provided in §§ 6651 and 6656. *See Diamond Plating Co. v. United States*, 390 F.3d 1035, 1038 (7th Cir. 2004); *East Wind Corp., Inc. v. United States*, 196 F.3d 499, 507-508 (3d Cir. 1999); *Fran Corp. v. United States*, 164 F.3d 814, 819 (2d Cir. 1999); *see also Staff IT, Inc. v. United*

States, 482 F.3d 792, 794 (5th Cir. 2007) (recognizing the circuit split but declining to take a side).

The Ninth Circuit's ruling in this case creates an even more complicated – and more senseless – division of authority. The Ninth Circuit had already held that inability to pay can constitute a defense to *civil* tax penalties. *See Van Camp & Bennion v. United States*, 251 F.3d 862 (9th Cir. 2001). But by overruling *Poll* and rejecting Mr. Easterday's appeal, the Ninth Circuit has now held that inability to pay cannot constitute a defense to *criminal* tax penalties.[2]

Thus, under the Ninth Circuit's current law, an employer who can demonstrate serious financial hardship may be liable for criminal penalties under § 7202 even though he may not be liable for civil penalties under §§ 6651 and 6656. That result makes sense neither as a matter of statutory interpretation nor as a matter of logic.

Neither the civil statutes nor the criminal statute explicitly mention financial distress. The criminal statute states that criminal penalties may be imposed only where an employer "willfully fails" to pay over payroll taxes. 26 U.S.C. § 7202. The civil statute states that civil penalties may be imposed for failures to pay unless such failures are "due to reasonable

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[2] Although both Mr. Easterday and the government discussed the applicability of *Van Camp* in their arguments to the panel, the panel did not attempt to reconcile its holding with *Van Camp*. In fact, it failed to cite *Van Camp*.

cause and not due to willful neglect." 26 U.S.C. § 6651(a) (reproduced in full at App. 46-47). In other words, as a textual matter, neither statute mentions ability to pay, but both statutes rest liability on willfulness. The Treasury regulations interpreting the civil provision state that:

> A failure to pay will be considered to be due to reasonable cause to the extent that the taxpayer has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship . . . if he paid on the due date.

26 C.F.R. § 301.6651-1(c)(1) (reproduced in full at App. 58-60). Thus, the Treasury Department itself has concluded that the willfulness provision in the civil statute implicitly provides that undue financial hardship negates liability for civil penalties. A majority of circuit courts have in turn held that taxpayers may not be liable if they "chose to pay other creditors and employees instead of the IRS" so long as that decision was reasonable in the exercise of ordinary business prudence. *East Wind*, 196 F.3d at 506.

It is a fundamental principle of statutory construction that terms should be interpreted consistently with their use in other statutes, especially other statutes concerning the same subject matter. *See Carcieri v. Salazar*, 129 S. Ct. 1058, 1064 (2009); 2B N. Singer, *Sutherland on Statutory Construction* § 51.1 (7th ed. 2008) (discussing the "principle that

statutes in pari materia should be construed together"). Absent an explicit direction to the contrary from Congress, the criminal penalty provision should be read in pari materia with the civil penalty provision. Thus, if willfulness in the civil statute may be negated by a showing of financial hardship, willfulness in the criminal statute may also be negated by a showing of financial hardship.

Moreover, even aside from the principles of statutory construction, it makes no sense as a matter of policy that criminal tax liability would be broader than civil tax liability. Civil tax liability is intended to be broader than criminal tax liability. *See e.g.*, *Cheek v. United States*, 498 U.S. 192, 207-209 (1991) (Scalia, J., concurring). It thus defies logic to allow a financial hardship defense to the former but not the latter. If anything, the defenses available to criminal sanctions ought to be broader. At a minimum, given that financial hardship has been recognized by several circuits as a defense to civil liability, it should also be recognized as a defense to criminal liability.

Prior to the Ninth Circuit's ruling in this case, there was already a division of authority among the circuits as to whether financial distress constitutes a defense to civil tax penalties. The Ninth Circuit's ruling below has added to the confusion by creating a new division of authority between civil and criminal cases. The taxpayer is caught in the middle. Is it true that a taxpayer may not be liable if they "chose to pay other creditors and employees instead of the IRS" so long as that decision was reasonable in the exercise of

ordinary business prudence, as the Third Circuit and others have held? Or will the taxpayer suffer a substantial prison term if he follows that rule, as happened to Mr. Easterday? Review is necessary to clarify the law and to eliminate the growing confusion in the lower courts.

2. Review is Necessary to Settle Whether There is a Specific Necessity Defense to Federal Tax Prosecutions and Also Whether There is a General Necessity Defense to Federal Crimes

In addition to settling the specific conflict discussed above, review is also warranted for a broader reason: to settle whether there exists a general necessity or "choice-of-evils" defense in federal law. The necessity defense exculpates a defendant who commits a crime in order to avoid some greater harm or evil. *See* LaFave, Criminal Law § 10.1(a) at 523 (4th ed. 2003); *see also* ALI, *Model Penal Code* § 3.02 (1962) ("Conduct which the actor believes to be necessary to avoid a harm or evil to himself or another is justifiable, provided that . . . the harm or evil sought to be avoided by such conduct is greater than that sought to be prevented by the law defining the offense charged. . . .").

This Court addressed the necessity defense in *United States v. Oakland Cannabis Buyers' Cooperative*, 532 U.S. 483 (2001). In that case, the Cooperative argued that the Controlled Substances Act

contained an implicit necessity defense. This Court rejected that specific argument, but left open the important question regarding the general availability of the necessity defense in federal criminal law.

> [W]e note that it is an open question whether federal courts ever have authority to recognize a necessity defense not provided by statute. A necessity defense "traditionally covered the situation where physical forces beyond the actor's control rendered illegal conduct the lesser of two evils." *United States v. Bailey*, 444 U.S. 394, 410 (1980). Even at common law, the defense of necessity was somewhat controversial. *See, e.g., Queen v. Dudley & Stephens*, 14 QB 273 (1884). And under our constitutional system, in which federal crimes are defined by statute rather than by common law, *see United States v. Hudson*, 11 U.S. 32, 7 Cranch 32, 34, 3 L. Ed. 259 (1812), it is especially so. As we have stated: "Whether, as a policy matter, an exemption should be created is a question for legislative judgment, not judicial inference." *United States v. Rutherford*, 442 U.S. 544, 559 (1979). Nonetheless, we recognize that this Court has discussed the possibility of a necessity defense without altogether rejecting it. *See, e.g., Bailey, supra*, at 415.
>
> We need not decide, however, whether necessity can ever be a defense when the federal statute does not expressly provide for it. In this case, to resolve the question presented, we need only recognize that a medical necessity exception for marijuana is at odds

> with the terms of the Controlled Substances Act. The statute, to be sure, does not explicitly abrogate the defense. But its provisions leave no doubt that the defense is unavailable.

Id. at 490-491 (footnotes omitted).

The concurring opinion agreed with the specific holding but argued that "our precedent has expressed no doubt about the viability of the common-law defense, even in the context of federal criminal statutes that do not provide for it in so many words." *Id.* at 501 (Stevens, J., concurring).

Several lower courts and commentators interpreted the *Oakland Cannabis Buyers' Cooperative* opinion as questioning the validity of the necessity defense. But only a few years later, in *Dixon v. United States*, 548 U.S. 1, 13 (2006), this Court recognized an implicit duress defense to the Safe Streets Act. Duress and necessity are closely related defenses, so the opinion in *Dixon* muddied the waters further.

This Court's failure to take a clear stand on the necessity defense has created confusion and uncertainty in the lower courts. *See, e.g.*, *United States v. Baker*, 523 F.3d 1141, 1142 (10th Cir. 2008) (McConnell, J., dissenting from denial of rehearing en banc); *see also* Stephen S. Schwartz, *Is There a Common Law Necessity Defense in Federal Criminal Law?*, 75 U. Chi. L. Rev. 1259 (2008). The question, moreover, has increased salience in light of recent arguments that coercive interrogation of suspected

terrorists, even if otherwise illegal, might be justified by necessity. *See* Eric A. Posner & Adrian Vermeule, *Should Coercive Interrogation Be Legal?*, 104 Mich. L. Rev. 671 (2006).[3]

A defense of financial distress to a criminal tax prosecution is simply a species of the general necessity defense. In this case, Mr. Easterday sought to demonstrate that using payroll tax money to fund his nursing homes was the lesser of two evils. He sought to argue, in other words, that paying his taxes on time would have required him to cease operations, which would have caused immense distress to his employees and, above all, to his elderly patients. The district court, however, held as a matter of law that no such defense is available in tax prosecutions. It implicitly held, in other words, that necessity is never a defense to prosecutions under § 7202.

The specific question of whether there is a choice-of-evils defense to tax prosecutions is itself important. Addressing that question would also allow this Court to address the more general – and immensely important – question of whether there is a necessity defense available for federal crimes. That is a question

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[3] *See also* Jay S. Bybee, *Memorandum for Alberto R. Gonzales, Counsel to the President, from Jay S. Bybee, Assistant Attorney General, Office of Legal Counsel, Re: Standards of Conduct for Interrogation under 18 U.S.C. §§ 2340-2340A* at 2 (August 1, 2002) ("We conclude that, under the current circumstances, necessity or self-defense may justify interrogation methods that might violate Section 2340A [the criminal torture statute].").

that this Court has intentionally left open in past cases. This case offers an opportunity to settle it.

CONCLUSION

Mr. Easterday sought to present a defense that due to the financial distress of his nursing homes, paying his payroll taxes would have caused an immensely greater evil. He was prevented from doing so. Currently, there is a split of authority regarding whether inability to pay constitutes a defense to civil or criminal tax penalties. That split is one part of the larger theoretical dispute about whether there is a general necessity defense in federal law. This Court should grant certiorari in order to settle these important questions.

Dated: July 2, 2009

Respectfully submitted,

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2009 WL 1109422

United States Court of Appeals,
Ninth Circuit.

UNITED STATES of America, Plaintiff-Appellee,
v.
Jack E. EASTERDAY, Defendant-Appellant.
No. 07-10347.

Argued and Submitted June 10, 2008.
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Dennis P. Riordan, San Francisco, CA, for defendant-appellant Jack E. Easterday.

Appeal from the United States District Court for the Northern District of California, Charles R. Breyer, District Judge, Presiding. D.C. No. CR-05-00150-CRB.

Before MARY M. SCHROEDER and N. RANDY SMITH, Circuit Judges, and VALERIE BAKER FAIRBANK,1* District Judge.

Opinion by Judge SCHROEDER; Dissent by Judge N.R. SMITH.

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* The Honorable Valerie Baker Fairbank, United States District Judge for the Central District of California, sitting by designation.

ORDER

The opinion filed August 22, 2008, and appearing at 539 F.3d 1176 (9th Cir.2008), is hereby amended. The amended opinion is filed concurrently with this Order.

With this amendment, Judge Schroeder has voted to deny the petition for rehearing en banc, and Judge Fairbank has so recommended. Judge N.R. Smith has voted to grant the petition for rehearing en banc.

The full court has been advised of the petition for rehearing en banc and no judge has requested a vote on whether to rehear the matter en banc. Fed. R.App. P. 35.

The petition for rehearing en banc is DENIED. No further petitions for rehearing or rehearing en banc will be accepted.

OPINION

SCHROEDER, Circuit Judge:

This case illustrates the enduring truth of Ben Franklin's sage observation that "nothing is certain but death and taxes." It is an appeal from a conviction for willful failure to pay over employee payroll taxes, in violation of 26 U.S.C. § 7202. The defendant-appellant, Jack Easterday, sought an "ability to pay instruction" in order to contend to the jury that his failure to pay over the taxes he owed was not

"willful," because he had spent the money on other business expenses and therefore could not pay it to the government when it was due. The district court refused to give the instruction, and Easterday subsequently was convicted and sentenced to thirty months in prison.

The requested instruction was drawn from a portion of a 1975 decision of this court, *United States v. Poll,* 521 F.2d 329 (9th Cir.1975), that we have never subsequently cited favorably in the context of a prosecution for failure to pay taxes. *Poll* in turn relied upon an earlier Ninth Circuit decision, *United States v. Andros,* 484 F.2d 531 (9th Cir.1973), that two other circuits have expressly rejected. *See United States v. Tucker,* 686 F.2d 230, 233 (5th Cir.1982); *United States v. Ausmus,* 774 F.2d 722, 725 (6th Cir.1985). Most significantly, the holding of *Poll* that formed the basis for the proposed instruction was effectively eradicated by subsequent Supreme Court authority.

Easterday contends that *Poll* is binding on us because this court has never expressly overruled it. The district court held that *Poll* was no longer good law. We agree with the district court. *Poll*'s requirement that the government prove that the taxpayer had sufficient funds to pay the tax was premised on a definition of willfulness that included some element of evil motive. The Supreme Court subsequently rejected any such definition of willfulness in the tax statutes. *See United States v. Pomponio,* 429 U.S. 10, 12, 97 S.Ct. 22, 50 L.Ed.2d 12 (1976) (per curiam); *see also Cheek v. U.S.,* 498 U.S. 192, 201-02, 111 S.Ct.

604, 112 L.Ed.2d 617 (1991). "Willful" in the tax context means a voluntary, intentional violation of a known legal duty. *See Cheek,* 498 U.S. at 201-02, 111 S.Ct. 604; *United States v. Powell,* 955 F.2d 1206, 1211 (9th Cir.1992). In other words, if you know that you owe taxes and you do not pay them, you have acted willfully. *Poll* has continued to be referred to occasionally in other contexts, principally in the child support area. *See United States v. Ballek,* 170 F.3d 871, 874 (9th Cir.1999); H.R.Rep. No. 102-771, at 6 (1992). It is not, however, good tax law. We therefore affirm.

Background

Easterday operated a chain of nursing homes in Northern California through a parent corporation, Employee Equity Administration ("EEA"), and its subsidiaries. Between 1998 and 2005, the total payroll tax liability for EEA and its subsidiaries for the period from the fourth quarter of 1998 through the fourth quarter of 2005 was $44,864,162, of which $26,018,869 was paid. Although the companies' tax filings accurately stated its tax liabilities, Easterday, through the corporation, repeatedly failed to pay over to the Internal Revenue Service ("IRS") the full amount of payroll taxes due.

The IRS sent Easterday's companies numerous notices requesting payment of the delinquent taxes. When those notices did not result in payment, the IRS sent notices informing Easterday's companies

of an intent to levy against each company's assets. Although Easterday was cooperative with the IRS and took full responsibility for the tax delinquency, his pattern of nonpayment continued. The IRS assessed liens against corporate accounts, but when payment was still not forthcoming, it eventually filed criminal charges. In 2005, the government charged Easterday with 109 counts of failure to pay over taxes in violation of 26 U.S.C. § 7202, with each count representing a different quarter in which the taxes of EEA and its subsidiaries were deficient.

Easterday did not dispute that he failed to pay the taxes when due. His defense was simply that he lacked the financial ability to comply with his tax obligations. Although the district court ruled that ability to pay was not relevant, Easterday was able to put on testimony that the nursing homes were struggling financially and he had trouble paying the bills, with losses of more than $20,000,000 between 1996 and 2005.

Easterday's witnesses testified, in essence, that Easterday did not pay the payroll taxes because he used the money to pay other company bills in order to keep the nursing homes operational. Easterday asked the court to instruct the jury that the government, in order to prove a willful failure to pay taxes, must prove that at the time the taxes were due, the taxpayer had the funds, and hence the ability to pay the obligation. Easterday's proposed instruction was drawn in part from the opinion in *United States v. Poll*, and provided as follows:

> The word "willfully" means a voluntary, intentional violation of a known legal duty, and not through ignorance, mistake, negligence, even gross negligence, or accident. In other words, the defendant must have acted voluntarily and intentionally and with the specific intent to do something he knew the law prohibited; that is to say, with the intent either to disobey or disregard the law.
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> . . . .
>
> In the context of this case, in order for the government to meet its burden of willfulness beyond a reasonable doubt, it must prove that on the dates the taxes were due the taxpayer possessed sufficient funds to be able to meet his legal obligations to the government or that the lack of sufficient funds on such date was created by (or was the result of) a voluntary and intentional act, without justification in light of the financial circumstances of the taxpayer.

The district court declined to give this instruction, but did instruct the jury that the government had the burden of proving that the defendant did not have a good faith belief that he was complying with the tax laws, and that a defendant's belief could be in good faith even if it was unreasonable. The court also instructed the jury that "[t]he tax laws do not permit an employer to choose to use the monies held in trust for the United States for other purposes, such as to pay business expenses."

Following a six-day jury trial, Easterday was found guilty on 107 of 109 counts. The district court denied Easterday's motion for a judgment of acquittal or a new trial and sentenced him to 30 months imprisonment, followed by three years supervised release. Easterday now appeals from the judgment and sentence.

Easterday's principal contention on appeal is that pursuant to *United States v. Poll,* he was entitled to a jury instruction on the ability to pay "element" of 26 U.S.C. § 7202, and he was entitled to present evidence to negate that "element." Accordingly, Easterday argues that the district court erred in declining to give a *Poll* instruction and that it abused its discretion by limiting the testimony Easterday could offer concerning the financial situation of, and burdens on, his companies.

Discussion

The statute under which Easterday was found guilty is 26 U.S.C. § 7202, a fairly rarely invoked provision that criminalizes a willful failure to pay over employees' federal income withholding taxes on wages. Section 7202 provides that "[a]ny person required . . . to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall . . . be guilty of a felony."

The main issue in this appeal, as well as a subject of considerable debate before the district

court, pertains to the status of *Poll,* and to what constitutes "willfulness" under the Tax Code. Specifically, the parties disagree as to whether "willfulness" requires an affirmative showing by the government that a defendant had an ability to pay his tax obligations and whether it can be negated by a showing that a defendant was financially unable to satisfy his tax debt. This court has not meaningfully revisited this issue since the 1970s.

In *United States v. Andros,* 484 F.2d 531, 533-34 (9th Cir.1973), we said that to establish the "wilful failure to pay the taxes assessed," the government must prove that, on the date the taxes were due, the taxpayer possessed "sufficient funds" to pay the taxes, and that the taxpayer voluntarily and intentionally did not pay them. We went on to say: "the requirement of wilfulness connotes 'bad faith or evil intent' or 'evil motive and want of justification in view of all the financial circumstances of the taxpayer.'" *Id.* at 534 (quoting *United States v. Bishop,* 412 U.S. 346, 93 S.Ct. 2008, 36 L.Ed.2d 941 (1973)).

Two years later, in *United States v. Poll,* this court apparently found plausible the taxpayer's contention that the failure to pay over the taxes could not be considered "willful" because he had offered to prove "that the corporation lacked the liquid resources to pay the full amounts due and that he intended to make up the deficiencies later." 521 F.2d at 330-31. Citing to *Andros* and *Spies v. United States,* 317 U.S. 492, 497-98, 63 S.Ct. 364, 87 L.Ed. 418 (1943), we held that Poll's offer of proof regarding

the liquid resources of the corporation was relevant to the determination of whether the failure to pay over taxes was willful. 521 F.2d at 332. In the language that Easterday sought to include as part of the charge to the jury in this case, we said:

> [T]o establish willfulness the Government must establish beyond a reasonable doubt that at the time payment was due the taxpayer possessed sufficient funds to enable him to meet his obligation or that the lack of sufficient funds on such date was created by (or was the result of) a voluntary and intentional act without justification in view of all the financial circumstances of the taxpayer.

Id. at 333.

This holding in *Poll* regarding ability to pay relied upon a definition of willfulness, taken from *Spies* and *Andros,* that included an element of "evil motive." 521 F.2d at 333 (citing *Spies,* 317 U.S. at 498, 63 S.Ct. 364). We recognized this in *Sorenson v. United States,* 521 F.2d 325, 328 n. 3 (9th Cir.1975) (quoting *Spies,* 317 U.S. at 498, 63 S.Ct. 364), where we said: "The *Poll* holding is only applicable to the criminal test of willfulness which requires 'some element of evil motive and want of justification in view of all the financial circumstances of the taxpayer.'"

The year after this court decided *Poll,* the United States Supreme Court decided *United States v. Pomponio,* 429 U.S. 10, 97 S.Ct. 22, 50 L.Ed.2d 12 (1976) (per curiam), in which it repudiated this

formulation of willfulness. In *Pomponio,* the Court examined the various formulations that had been used for the definition of "willfully" in the Tax Code. *See id.* at 12, 97 S.Ct. 22. The Court attempted to dissipate the confusion that had arisen from its decision in *United States v. Bishop,* 412 U.S. 346, 93 S.Ct. 2008, 36 L.Ed.2d 941 (1973), in which the Court referred to a number of formulations of the standard, including the formulation it used in *Spies,* of "evil motive and want of justification in view of all the financial circumstances of the taxpayer."

The troublesome paragraph in *Bishop* was the following:

> The Court, in fact, has recognized that the word 'willfully' in these statutes generally connotes a voluntary, intentional violation of a known legal duty. It has formulated the requirement of willfulness as 'bad faith or evil intent,' *United States v. Murdock,* 290 U.S. 389, 398, 54 S.Ct. 223, 78 L.Ed. 381, or 'evil motive and want of justification in view of all the financial circumstances of the taxpayer,' *Spies v. United States,* 317 U.S. 492, 498, 63 S.Ct. 364, 87 L.Ed. 418, or knowledge that the taxpayer 'should have reported more income than he did.' *Sansone v. United States,* 380 U.S. 343, 353, 85 S.Ct. 1004, 13 L.Ed.2d 882. *See James v. United States,* 366 U.S. 213, 221, 81 S.Ct. 1052, 6 L.Ed.2d 246; *McCarthy v. United States,* 394 U.S. 459, 471, 89 S.Ct. 1166, 22 L.Ed.2d 418.

412 U.S. at 360, 93 S.Ct. 2008.

The court in *Pomponio* endeavored to erase the misconception that such different formulations, including the "evil motive" formulation of *Spies,* actually established different standards. The Court clarified that "willfulness" means a voluntary, intentional violation of a known legal duty, and does not "require[ ] proof of any [other] motivative." 429 U.S. at 12, 97 S.Ct. 22. The Court said, "Our references to other formulations of the standard did not modify [that] standard." *Id.* The Court explained that *Bishop* "did not . . . hold that the term requires proof of any motive other than an intentional violation of a known legal duty." *Id.*

Accordingly, the portion of our decision in *Poll* which created an additional requirement of proving ability to pay has been undermined by the Supreme Court's subsequent decision in *Pomponio. Poll* is not consistent with the intervening authority of the United States Supreme Court that must control our decision here.

In support of his contention that *Poll* nevertheless remains good law, Easterday argues that *Pomponio* is "coextensive" with this court's earlier determination in *United States v. Hawk,* 497 F.2d 365, 368 (9th Cir.1974), that neither bad purpose nor evil motive is an independent element of willfulness. Easterday reasons that because *Poll* stated that it was consistent with *Hawk,* and *Pomponio* approved *Hawk,* then *Poll* is still good law.

This argument does not withstand close analysis. *Poll* involved a charge of willful failure to collect or pay over tax. *Poll* distinguished *Hawk* on the basis that the offense charged in *Hawk* "was a *willful failure to file federal income tax returns.*" *Poll,* 521 F.2d at 332 (emphasis in original). Therefore, instead of following *Hawk, Poll* followed our earlier decision in *Andros* because *Andros* involved prosecution of a willful failure to pay a tax. *Id. Andros,* in turn, had followed the Supreme Court's decision in *Spies.* In *Poll,* we quoted at length from *Spies,* highlighting its statement with respect to a charge of willful failure to pay a tax, that "*[w]e would expect willfulness in such a case to include some element of evil motive and want of justification in view of all the financial circumstances of the taxpayer.*" *Poll,* 521 F.2d at 333 (citing *Spies,* 317 U.S. at 498, 63 S.Ct. 364) (emphasis in original). Because *Poll* applied the *Spies* "evil motive" formulation of willfulness, and expressly distinguished *Hawk, Poll* held that financial circumstances were relevant to proof of willfulness under 26 U.S.C. § 7202.

Later, in *Pomponio,* the Supreme Court approved the willfulness formulation of *Hawk,* but disapproved the "evil motive" formulation of *Spies,* holding that the standard is the same in all tax contexts. It approved the standard iterated in *Bishop*: "a voluntary, intentional violation of a known legal duty," and continued, "[o]ur references to other formulations of the standard did not modify the standard set forth in [*Bishop*]." *Pomponio,* 429 U.S. at 12-13, 97 S.Ct. 22. *Pomponio*

thus undermines the heart of *Poll*'s holding that financial circumstances are relevant to a determination of willfulness under § 7202, failure to collect or pay over tax. This is because *Pomponio* expressly repudiates *Spies*' "evil motive" formulation on which *Poll* relied. 429 U.S. at 11-12, 97 S.Ct. 22.

The dissent, however, insists that the basis for *Poll*'s requirement of proving an "ability to pay" has not been undermined. It does so because it fails to recognize that the *Poll* requirement was founded upon the *Spies* formulation of willfulness that the Supreme Court rejected in *Pomponio*. Although the dissent agrees that *Pomponio* intended to do away with the misconception that the "evil motive" formulation of *Spies* established a different standard of willfulness, the dissent fails to recognize that *Poll*'s holding rested on just such a misconception.

This court, in *Poll*, thus held that the ability to pay was relevant to the charge of willful failure to collect or pay over tax because of *Spies*' incorporation of an element of "evil motive" into the requirement of willfulness in such tax cases. After *Pomponio*, we must hold that there is no longer any requirement of evil motive, upon which *Poll*'s holding rested.

We therefore hold that insofar as *Poll* may be interpreted as requiring the government, in a failure to pay case under § 7202, to prove that defendant had the money to pay the taxes when due, and allowing the defendant to defend on the ground that he had

spent the money for other expenses, *Poll* is inconsistent with *Pomponio.* It is also inconsistent with common sense, for we think it unlikely that even under *Poll* and *Spies,* a defendant could succeed in arguing that he did not willfully fail to pay because he spent the money on something else. *Cf. United States v. Gilbert,* 266 F.3d 1180, 1185 (9th Cir.2001) (concluding that defendant's "act of paying wages to his employees, instead of remitting withholding taxes to the IRS, shows that he voluntarily and intentionally violated § 7202").

Indeed, in rejecting *Andros* and *Poll,* two of our sister circuits have made that very point. In *United States v. Tucker,* 686 F.2d 230 (5th Cir.1982), a prosecution for willfully failing to pay income taxes, under 26 U.S.C. § 7203, the defendant argued that he could not pay the taxes when they were due because he had no assets to satisfy the debt and that his failure to pay was not willful. The Fifth Circuit said that "[t]his argument borders on the ridiculous. . . . [A] financial ability to pay the tax when it comes due is not a prerequisite to criminal liability under § 7203. Otherwise, a recalcitrant taxpayer could simply dissipate his liquid assets at or near the time when his taxes come due and thereby evade criminal liability." *Id.* at 233. In *United States v. Ausmus,* 774 F.2d 722, 725 (6th Cir.1985), the Sixth Circuit "rejected" the language in *Andros* that suggested financial ability to pay was relevant to criminal liability. The court said, "[o]therwise, a recalcitrant taxpayer could spend his money as fast as he earns it and evade criminal

liability while not paying taxes as long as his bank balance is zero when the taxpayer's taxes are due." *Id.* Despite what we consider to be the unassailable logic presented by our sister circuits here, Easterday asks us to follow the contrary reasoning of *Andros* and *Poll* essentially because we have never formally repudiated it before now.

While we may not have explicitly overruled *Poll* or *Andros* in the more than three decades since we issued those opinions, neither have we cited them for the proposition that Easterday asserts here. *Poll* is not completely dead, for it has been used as a shorthand term describing the standard of "willful failure" to pay that has been discussed in the context of child support. *See United States v. Ballek,* 170 F.3d 871, 874 (9th Cir.1999); H.R.Rep. No. 102-771, at 6 (1992). In the tax field, however, it now exists only as a nearly completely buried obstacle to traffic that generally has run over it or passed it by for more than thirty years.

The only remaining question is whether we are nevertheless bound by *Poll* because it has not been overruled by an en banc court. Generally, a panel opinion is binding on subsequent panels unless and until overruled by an en banc decision of this circuit. *See, e.g., Ross Island Sand & Gravel v. Matson,* 226 F.3d 1015, 1018 (9th Cir.2000) (per curiam) ("[A]bsent a rehearing en banc, we are without authority to overrule [controlling circuit precedent].").

In *Miller v. Gammie,* 335 F.3d 889 (9th Cir.2003), we convened an en banc court to consider the question of when a panel decision may be overruled by intervening higher authority that, while not on an identical issue or expressly repudiating the panel decision, is inconsistent with its reasoning. We held that en banc review is not required to overturn a case where "intervening Supreme Court authority is clearly irreconcilable with our prior circuit authority." *Id.* at 900. We explained that we must avoid inconsistencies between our decisions and the decisions of a court of last resort. We said:

> We must recognize that we are an intermediate appellate court. A goal of our circuit's decisions, including panel and en banc decisions, must be to preserve the consistency of circuit law. The goal is codified in procedures governing en banc review. *See* 28 U.S.C. § 46; Fed. R.App. P. 35. That objective, however, must not be pursued at the expense of creating an inconsistency between our circuit decisions and the reasoning of state or federal authority embodied in a decision of a court of last resort.
>
> We hold that the issues decided by the higher court need not be identical in order to be controlling. Rather, the relevant court of last resort must have undercut the theory or reasoning underlying the prior circuit precedent in such a way that the cases are clearly irreconcilable.

335 F.3d at 900.

Pursuant to *Miller,* we conclude that it is not necessary to convene an en banc court in order to hold that *Poll,* and its antecedent *Andros,* are no longer binding authority for the proposition that a defendant's ability to pay his tax liability is relevant to the determination of willfulness under 26 U.S.C. § 7202. In keeping with *Pomponio,* 429 U.S. at 12, 97 S.Ct. 22, and *Cheek,* 498 U.S. at 201-02, 111 S.Ct. 604, we hold that willfulness does not require the government to prove that a defendant had the ability to meet his tax obligations. The district court's refusal to give a *Poll* instruction to the jury and the instruction it did give on willfulness were thus proper.

For similar reasons, the district court did not abuse its discretion in refusing to admit evidence proffered by Easterday in order to show how and why he spent money owed to the IRS to pay other business expenses. Such evidence would have been relevant only if a defendant were entitled to defend on the ground that he had spent the tax money for other needs. Because the financial circumstances of a defendant do not bear on the determination of willfulness under § 7202, Easterday's proffered evidence was irrelevant, and the district court did not abuse its discretion by excluding it. *See* Fed.R.Evid. 401.

Easterday's remaining contentions are without merit.

AFFIRMED.

N.R. SMITH, Circuit Judge, dissenting:

In this case, I find myself between "the proverbial rock and a hard place." I can either adhere to precedent (with which I do not agree) or I can join the majority and try to overrule bad circuit precedent. Although I agree that *United States v. Poll,* 521 F.2d 329 (9th Cir.1975) is bad law, *Poll* is the controlling law of this circuit and I understand a three-judge panel is not able to undo precedent set forth by another three-judge panel. *See Hulteen v. AT & T Corp.,* 498 F.3d 1001, 1009 (9th Cir.2007) ("A three-judge panel must follow a prior circuit decision unless a subsequent decision by a relevant court of last resort either effectively overrules the decision in a case 'closely on point' or undercuts the reasoning underlying the circuit precedent rendering the cases 'clearly irreconcilable.'" (citation omitted)). In my view, because *Poll* is not irreconcilable with *United States v. Pomponio,* 429 U.S. 10, 97 S.Ct. 22, 50 L.Ed.2d 12 (1976) (per curiam), we are required to either follow *Poll* or make a sua sponte en banc call. *See In re Complaint of Ross Island Sand & Gravel,* 226 F.3d 1015, 1018 (9th Cir.2000) (per curiam) ("[A]bsent a rehearing en banc, we are without authority to overrule [controlling circuit precedent].").

The majority, however, has chosen to write around circuit precedent in order to avoid a result that they do not like. I therefore respectfully dissent for the following reasons. First, the majority legally errs by finding that *Poll* is no longer good law. Second, because of its error in finding that *Poll* was

overruled by *Pomponio*, the majority incorrectly affirms the district court in its refusal to instruct the jury that the government must prove that Easterday had the financial ability to meet his tax obligations. Thus, I would reverse and remand for a new trial, because Easterday's ability to pay was an element of the crime the government needed to prove beyond a reasonable doubt.

I. Discussion

Poll discusses two separate questions: (a) willfulness, and (b) the relevance of evidence demonstrating an inability to pay in order to rebut the willfulness of a failure to pay over employee payroll taxes. *See* 521 F.2d at 331 ("These actions raise two questions: Viz. whether the foregoing definition of 'willfully' is correct and whether the evidence offered to rebut the presence of willfulness was irrelevant and inadmissible."). In *Poll*, we held that the willfulness definition was correct, and that the evidence of inability to pay was relevant to rebut the presence of willfulness. *See id.*

The majority, however, incorrectly concludes that "*Poll*'s requirement that the government prove that the taxpayer had sufficient funds to pay the tax was premised on a definition of willfulness that included some element of evil motive." In *Poll*, we based our holding, in part, on Supreme Court precedent found in *Spies v. United States*, 317 U.S. 492, 498, 63 S.Ct. 364, 87 L.Ed. 418 (1943), which states that "[w]e

would expect willfulness . . . to include some element of evil motive and want of justification in view of all the financial circumstances of the taxpayer." *Poll,* 521 F.2d at 333. We also, however, relied on *United States v. Hawk,* 497 F.2d 365 (9th Cir.1974) to recognize that it is "not error to fail to include the words 'and/or evil motive'" when determining the "willfully" standard. *Poll,* 521 F.2d at 332.

The majority correctly recognizes that the Supreme Court "in *Pomponio* endeavored to erase the misconception that such different formulations, including the 'evil motive' formulation of *Spies,* actually established different standards." In *Pomponio,* the Court held that the term "willfully" does not require "proof of any motive other than an intentional violation of a known legal duty." 429 U.S. at 12, 97 S.Ct. 22. The Court explained the meaning of willfulness by stating that

> The Court, in fact, has recognized that the word "willfully" . . . generally connotes a voluntary, intentional violation of a known legal duty. It has formulated the requirement of willfulness as "bad faith or evil intent," or "evil motive and want of justification in view of all the financial circumstances of the taxpayer," or knowledge that the taxpayer "should have reported more income than he did."
>
> Our references to other formulations of the standard did not modify the standard [that the word 'willfully' . . . generally connotes a

> voluntary, intentional violation of a known legal duty].

Id. (internal citations and quotations omitted).

Thus, even when the formulation of "evil motive" or "bad purpose" is used in explaining the standard for willfulness, the standard is not modified. Willfulness, in the context of tax laws, "simply means a *voluntary, intentional* violation of a known legal duty." *Id.* at 12-13, 97 S.Ct. 22 (emphasis added) (citing *Hawk,* 497 F.2d at 368); *see also Cheek v. United States,* 498 U.S. 192, 201-02, 111 S.Ct. 604, 112 L.Ed.2d 617 (1991). There is no requirement the government prove bad purpose or evil motive and want of justification. *See Pomponio,* 429 U.S. at 12-13, 97 S.Ct. 22; *Hawk,* 497 F.2d at 368. The holding in *Poll* is therefore consistent with the *Pomponio* definition of willfulness.

In *Poll,* we held that "to establish willfulness the Government must establish beyond a reasonable doubt that at the time payment was due the taxpayer possessed sufficient funds to enable him to meet his obligation or that the lack of sufficient funds on such date was created by (or was the result of) a *voluntary* and *intentional* act without justification in view of all the financial circumstances of the taxpayer." 521 F.2d at 333 (emphasis added). Our holding in *Poll* therefore relied on the same definition of willfulness as determined in *Pomponio* ("a *voluntary, intentional* violation of a known legal duty"). In fact, *Pomponio* actually

supports that idea that *Poll* used the correct definition of willfulness. *See* 429 U.S. at 12-13, 97 S.Ct. 22 (noting that "as the other Courts of Appeals that have considered the question have recognized, willfulness in this context simply means a voluntary, intentional violation of a known legal duty" (citing *Hawk,* 497 F.2d at 366-69)).

As discussed, our determination of willfulness in *Poll* relied, in part, on *Hawk,* which the Supreme Court approved in *Pomponio.* In *Hawk,* we noted that the Supreme Court, in *United States v. Murdock,* 290 U.S. 389, 54 S.Ct. 223, 78 L.Ed. 381 (1933), held that

> [W]illfulness requires proof that the act was done with knowledge it was wrongful. The Court discussed a number of ways of expressing this type of specific intent, and among the terms mentioned were "bad purpose" and "evil motive."
>
> However, neither bad purpose nor evil motive is an independent element of a willful failure to file under § 7203. The term "evil motive" is merely a "convenient shorthand expression to distinguish liability based on conscious wrongdoing from liability based on mere carelessness or mistake." Thus the term expresses, in a brief way, the more cumbersomely stated concept of specific intent in *Murdock,* a concept the instructions must ultimately convey. This, we think, was all that *Murdock* – and *Bishop* – meant by the use of that term.

Hawk, 497 F.2d at 368 (internal citations omitted).

Thus, although *Poll* quoted Supreme Court precedent regarding the inclusion of "evil motive and want of justification" to determine willfulness, we were referencing the "voluntary, intentional violation of a known legal duty" formulation discussed in *Pomponio.* Even though the wording was different, Supreme Court precedent dictates that the meaning underlying the term "willfulness" in *Poll* was the same as used in *Hawk* and *Pomponio. Poll*'s definition of willfulness was not premised on a belief that willfulness requires an evil motive or bad purpose. *Poll,* therefore, still holds that the ability to pay is relevant to demonstrate willfulness, and *Pomponio* did not state otherwise. Although *Pomponio* did discuss the willfulness question, *see* 429 U.S. at 12-13, 97 S.Ct. 22, the portion of our decision in *Poll* that created an additional requirement of proving ability to pay was not undermined by *Pomponio.* The basis for *Poll*'s requirement of proving ability to pay has therefore not been eliminated. No subsequent decision from this circuit or from a relevant court of last resort has overruled the requirement presented in *Poll* that evidence regarding inability to pay is relevant to rebut the presence of willfulness. *See Poll,* 521 F.2d at 332 ("We believe, and so hold, that the defendant's offer of proof regarding the liquid resources of the corporation and his intention to make up the deficiencies later was relevant and admissible in his effort to refute the willfulness of the failure to pay over.").

Pomponio also did not overrule *Poll* because *Pomponio* and *Poll* address different issues. In *Pomponio,* the Supreme Court, affirming this court's holding in *Hawk,* held that evil motive is not an independent element of filing false income tax returns under 26 U.S.C. § 7206 and that instructions regarding evil motive are thus unnecessary. 429 U.S. at 12-13, 97 S.Ct. 22. In *Poll,* by contrast, this court considered whether the government must prove that a defendant was capable of meeting his tax obligations. 521 F.2d at 333. We specifically noted that the ability to pay rule was not contrary to *Hawk* because *Hawk* addressed "a [w]illful failure to file [a] federal income tax return[ ]," not a crime "involving a failure to pay." 521 F.2d at 332. Because *Pomponio* affirmed *Hawk,* and because this court held, in *Poll,* that the ability to pay rule is consistent with *Hawk, Poll* is consistent with *Pomponio.* Thus, *Pomponio* is not "clearly irreconcilable" with *Poll,* and *Poll* remains good law. *See Hulteen,* 498 F.3d at 1009. We are therefore bound by *Poll* because it has not been overruled by an en banc court. *See In re Complaint of Ross Island Sand & Gravel,* 226 F.3d at 1018.

The majority also references this court's decision in *United States v. Gilbert,* 266 F.3d 1180 (9th Cir.2001), for the proposition that *Poll* is inconsistent with both *Pomponio* and common sense. In *Gilbert,* the defendant argued "that his failure to pay over the withholding tax was not willful because [his business] did not have the funds to pay the taxes." 266 F.3d at 1185. The government responded "that it presented

sufficient evidence at trial that Gilbert voluntarily and intentionally paid net wages to his employees with knowledge that withholding taxes were not being remitted to the IRS." *Id.* This court affirmed on the basis that the evidence was sufficient. *See Id.* This court, however, did not explicitly or implicitly overrule the ability to pay rule. The district court in *Gilbert* had given a *Poll* instruction, and this court did not criticize the district court for having done so. In fact, this court did not reference the ability to pay rule or *Pomponio*. This court instead discussed how *Poll* did not concern "whether § 7202 required the failure [to *both* account for and pay over withholding tax], but instead addressed the issue of how to define willfulness under § 7202." *Id.* at 1183. This court held that "whether § 7202 required the failure to both account for and pay over the tax, were dicta." *Id.* That holding, however, does not address whether the ability to pay can be used as a defense. *Gilbert* therefore merely discusses whether § 7202 requires the failure to both account for *and* pay over withholding tax. Thus, there is no basis in *Gilbert* for the proposition that *Pomponio* overruled *Poll*.

To the extent the district court excluded evidence regarding the financial situation of Easterday's companies and his inability to pay (based on its flawed interpretation of *Pomponio*), the district court abused its discretion. *See United States v. Gallagher,* 99 F.3d 329, 331-32 (9th Cir.1996). Moreover, the district court's failure to instruct the jury that the government must prove that Easterday had the ability to

meet his tax obligations is a constitutional error "because the jury did not have the opportunity to find each element of the crime beyond a reasonable doubt." *Martinez v. Borg,* 937 F.2d 422, 423 (9th Cir.1991). The district court rejected a large amount of evidence regarding Easterday's nursing homes' financial difficulties. Because this evidence "could rationally lead to a contrary finding with respect to the omitted element," the district court's error was not harmless and Easterday is entitled to a new trial. *Neder v. United States,* 527 U.S. 1, 19, 119 S.Ct. 1827, 144 L.Ed.2d 35 (1999).

United States District Court
Northern District of California

UNITED STATES OF AMERICA	**JUDGMENT IN A CRIMINAL CASE**
v.	(Filed July 19, 2007)
JACK EDWARD EASTERDAY	USDC Case Number: CR-05-00150-001 CRB BOP Case Number: DCAN305CR000150-000 USM Number: Defendant's Attorney: Ted Cassman/Lauren Disston

THE DEFENDANT:

[ ] pleaded guilty to count(s) _____
[ ] pleaded nolo contendere to count(s) ___ which was accepted by the court.
[x] was found guilty on counts 1 thru 44, 46 thru 107 and 109 of the Superseding Information after a plea of not guilty

The defendant is adjudicated guilty of these offense(s):

Title & Section	Nature of Offense	Offense Ended	Counts
26 U.S.C. § 7202	Willful Failure to Truthfully account for and Pay Over Taxes	2005	1 through 44 46 through 107 and 109

The defendant is sentenced as provided in pages 2 through 6 of this judgment. The sentence is imposed pursuant to the Sentencing Reform Act of 1984.

[x] The defendant has been found not guilty on counts 45 and 108 of the Superseding Information

[ ] Count(s) ___ (is) (are) dismissed on the motion of the United States.

IT IS ORDERED that the defendant must notify the United States Attorney for this district within 30 days of any change of name, residence, or mailing address until all fines, restitution, costs, and special assessments imposed by this judgment are fully paid. If ordered to pay restitution, the defendant shall notify the court and United States attorney of material change in the defendant's economic circumstances.

July 13, 2007
Date of Imposition of Judgment

/s/ Charles R. Breyer
Signature of Judicial Officer

Honorable Charles R. Breyer,
U. S. District Judge
Name & Title of Judicial Officer

July 19, 2007
Date

IMPRISONMENT

The defendant is hereby committed to the custody of the United States Bureau of Prisons to be imprisoned for thirty (30) months on counts 1 through 44, thirty (30) months on counts 46 through 107 and thirty (30) months on count 109 with each count to

run concurrent with one another for a total term of thirty (30) months.

[ ] The court makes the following recommendations to the Bureau of Prisons:

[ ] The defendant is remanded to the custody of the United States Marshal. The appearance bond is hereby exonerated.

[ ] The defendant shall surrender to the United States Marshal for this district:

[ ] at _____ [ ] a.m. [ ] p.m. on _____.
[ ] as notified by the United States Marshal.

The appearance bond shall be deemed exonerated upon the surrender of the defendant.

[x] The defendant shall surrender for service of sentence at the institution designated by the Bureau of Prisons once judgment becomes final.

[ ] before 2:00 p.m. on _____.
[ ] as notified by the United States Marshal.
[ ] as notified by the Probation or Pretrial Services Office.

The defendant is continued on bail pending his appeal under the same conditions set at pretrial/post trial.

RETURN

I have executed this judgment as follows:

_____

_____

_____

Defendant delivered on _____ to _____ at _____ with a certified copy of this judgment.

_____
UNITED STATES MARSHAL

By _____

SUPERVISED RELEASE

Upon release from imprisonment, the defendant shall be on supervised release for a term of three (3) years as to counts 1 through 44, three (3) years on counts 46 through 107 and three (3) years on count 109 with each count to run concurrent.

The defendant must report to the probation office in the district to which the defendant is released within 72 hours of release from the custody of the Bureau of Prisons.

The defendant shall not commit another federal, state or local crime.

The defendant shall not unlawfully possess a controlled substance. The defendant shall refrain from any unlawful use of a controlled substance. The defendant shall submit to one drug test within 15 days of release from imprisonment and two periodic drug tests thereafter.

[x] The above drug testing condition is suspended based on the court's determination that the

defendant poses a low risk of future substance abuse. (Check if applicable.)

[x] The defendant shall not possess a firearm, ammunition, destructive device, or any other dangerous weapon. (Check if applicable.)

[x] The defendant shall cooperate in the collection of DNA as directed by the probation officer. (Check if applicable.)

[ ] The defendant shall register with the state sex offender registration agency in the state where the defendant resides, works, or is a student, as directed by the probation officer. (Check if applicable.)

[ ] The defendant shall participate in an approved program for domestic violence. (Check if applicable.)

If this judgment imposes a fine or restitution obligation, it is a condition of supervised release that the defendant pay in accordance with the Schedule of Payments sheet of this judgment.

The defendant must comply with the standard conditions that have been adopted by this court as well as with any additional conditions in this judgment.

STANDARD CONDITIONS

1) the defendant shall not leave the judicial district without the permission of the court or probation officer;

2) The defendant shall report to the probation officer and shall submit a truthful and complete written report within the first five days of each month;

3) The defendant shall answer truthfully all inquiries by the probation officer and follow the instructions of the probation officer;

4) The defendant shall support his or her dependents and meet other family responsibilities;

5) The defendant shall work regularly at a lawful occupation, unless excused by the probation officer for schooling, training, or other acceptable reasons;

6) The defendant shall notify the probation officer at least ten days prior to any change in residence or employment;

7) The defendant shall refrain from excessive use of alcohol and shall not purchase, possess, use, distribute, or administer any controlled substance or paraphernalia related to any controlled substances, except as prescribed by a physician;

8) The defendant shall not frequent places where controlled substances are illegally sold, used, distributed, or administered;

9) The defendant shall not associate with any persons engaged in criminal activity and shall not associate with any person convicted of a felony unless granted permission to do so by the probation officer;

10) The defendant shall permit a probation officer to visit him or her at any time at home or elsewhere,

and shall permit confiscation of any contraband observed in plain view by the probation officer;

11) The defendant shall notify the probation officer within seventy-two hours of being arrested or questioned by a law enforcement officer;

12) The defendant shall not enter into any agreement to act as an informer or a special agent of a law enforcement agency without the permission of the Court; and

13) As directed by the probation officer, the defendant shall notify third parties of risks that may be occasioned by the defendant's [sic]

SPECIAL CONDITIONS OF SUPERVISION

1) The defendant shall pay any (restitution and special assessment) (fine and special assessment) (restitution, fine and special assessment) (special assessment) that is imposed by this judgment, (and that remains unpaid at the commencement of the term of supervised release),

The defendant shall provide the probation officer access to any requested financial information, including tax returns, and shall authorize the probation office to conduct credit checks and obtain copies of income tax returns.

The defendant shall not open any new lines of credit and/or incur new debt without the prior permission of the probation officer.

The defendant shall comply and cooperate with the IRS in a good-faith effort to pay any outstanding tax liability, to include any assessed penalty and interest.

The defendant shall provide the U.S. Probation Office with a copy of any written and approved agreement with the IRS for the payment of any outstanding tax liability, to include penalty and interest, within 10 days from the execution of such agreement.

The defendant shall timely and accurately file all future income tax returns required by law during the term of supervision, unless an extension of time is granted by the IRS.

CRIMINAL MONETARY PENALTIES

The defendant must pay the total criminal monetary penalties under the schedule of payments on Sheet 6.

	Assessment	Fine	Restitution
Totals:	$10,700.00	$-0-	$8,710,795.84

[ ] The determination of restitution is deferred until ___. An *Amended Judgment in a Criminal Case* (AO 245C) will be entered after such determination.

[ ] The defendant shall make restitution (including community restitution) to the following payees in the amount listed below.

If the defendant makes a partial payment, each payee shall receive an approximately proportional payment unless specified otherwise in the priority order or percentage payment column below. However, pursuant to 18 U.S.C. § 3664(i), all nonfederal victims must be paid before the United States is paid.

Name of Payee(s)	Total Loss*	Restitution Ordered	Priority or Percentage
United States	$8,710,795.84	$8,710,795.84	
Totals:	$8,710,795.84	$8,710,795.84	

[x] Restitution amount ordered pursuant to plea agreement $ 8,710,795.84

[x] The defendant must pay interest on restitution and a fine of more than $2,500, unless the restitution or fine is paid in full before the fifteenth day after the date of the judgment, pursuant to 18 U.S.C. § 3612(f). All of the payment options on Sheet 6, may be subject to penalties for delinquency and default, pursuant to 18 U.S.C. § 3612(g).

[ ] The court determined that the defendant does not have the ability to pay interest, and it is ordered that:

[ ] The interest requirement is waived for the [ ] fine [ ] restitution.

---

* Findings for the total amount of losses are required under Chapters 109A, 110, 110A, and 113A of Title 18 for offenses committed on or after September 13, 1994, but before April 23, 1996.

[ ] The interest requirement for the
[ ] fine [ ] restitution is modified as follows:

SCHEDULE OF PAYMENTS

Having assessed the defendant's ability to pay, payment of the total criminal monetary penalties are due as follows:

A [x] Lump sum payment of $10,700.00 due immediately, balance due

[ ] not later than _____ , or

[x] in accordance (x) C, ( ) D, ( ) E, or (x) F below; or

B [ ] Payment to begin immediately (may be combined with ( ) C, ( ) D, ( ) F below); or

C [x] Payment in equal quarterly installments of $25.00 after the date of this judgment; or

D [ ] Payment in equal (e.g., weekly, monthly, quarterly) installments of $ _____ over a period of (e.g., months or years), to commence _____ (e.g., 30 or 60 days) after release from imprisonment to a term of supervision; or

E [ ] Payment during the term of supervised release will commence within (e.g., 30 or 60 days) after release from imprisonment to a term of supervision; or

F [x] Special instructions regarding the payment of criminal monetary penalties: While incarcerated, payment of restitution is due during imprisonment at the rate of not less than $25 per quarter and payment shall be through the Bureau of Prisons Inmate Financial Responsibility

Program. Restitution payments shall be made to the Clerk of U.S. District Court, Attention: Financial Unit, 450 Golden Gate Ave., Box 36060, San Francisco, CA 94102, in the amount of $2,500.00 due on the 15th of each month.

Unless the court has expressly ordered otherwise, if this judgment imposes imprisonment, payment of criminal monetary penalties is due during imprisonment. All criminal monetary penalties, except those payments made through the Federal Bureau of Prisons' Inmate Financial Responsibility Program, are made to the clerk of the court.

The defendant shall receive credit for all payments previously made toward any criminal monetary penalties imposed.

[ ] Joint and Several

Defendant and co-defendant Names	Case Numbers (including defendant number)	Total Amount	Joint and Several Amount	Corresponding Payee (if appropriate)

Payments shall be applied in the following order: (1) assessment, (2) restitution principal, (3) restitution interest, (4) fine principal, (5) fine interest, (6) community restitution, (7) penalties, and (8) costs, including cost of prosecution and court costs.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

JACK E. EASTERDAY,

Defendant.

/

No. CR 05-00150 CRB

ORDER DENYING MOTION FOR JUDGMENT OF ACQUITTAL OR ALTERNATIVELY FOR A NEW TRIAL

(Filed Jul. 12, 2007)

A jury convicted defendant of 107 out of 109 counts of willfully failing to collect, truthfully account for and pay over payroll taxes. Now pending before the Court is defendant's motion for judgment of acquittal or for a new trial. After carefully considering the parties' papers, and the evidence submitted at trial, the motion is DENIED.

BACKGROUND

On February 9, 2006 a jury convicted defendant of violating 26 U.S.C. section 7202 by failing to pay to the United States payroll taxes withheld from his employees. As defendant did not contest that he owed and failed to pay the taxes, a key issue in the case was willfulness. At the request of the defense, the district court to whom this case was previously assigned instructed the jury on the issue of willfulness as follows:

> The word "willfully" means a voluntary, intentional violation of a known legal duty. In other words, the defendant must have acted voluntarily and intentionally, not through ignorance, mistake, or accident and with the specific intent to do something he knew the law prohibited; that is to say, with the intent either to disobey or disregard the law.
>
> In the context of this case, in order for the government to establish willfulness beyond a reasonable doubt, it must prove that on the date the taxes were due, the taxpayer possessed sufficient funds to be able to meet his legal obligations to the government, or that the lack of sufficient funds on such date was created by or was the result of a voluntary and intentional act, and the taxpayer vountarily [sic] and intentionally, without justification in light of all the financial circumstances of the taxpayer, did not pay such taxes

The latter paragraph was derived, almost verbatim, from *United States v. Poll,* 521 F.2d 329, 333 (9th Cir. 1975).

The *Poll* instruction confused the jury. During deliberations the jury's first note explained that the jury was unclear as to what is meant by: "without justification in light of all the financial circumstances of the taxpayer, did not pay such taxes." In response, the district court instructed the jury as follows:

> Evidence that the defendant caused the corporation to pay other expenses may be

> evidence that the defendant's failure to assure that the corporation paid its taxes was willful. Evidence that the defendant caused the corporation to pay other expenses in a particular quarter knowing that the taxes had not been paid in previous quarters, and that funds would not be available to pay the taxes in the current quarter, may be evidence that the defendant's failure to assure that the corporation paid its taxes was willful.

Defendant objected to this instruction and moved for a mistrial on the ground that it eliminated his "ability to pay" defense, that is, his *Poll* defense.

The jury sent another note that suggested it was considering whether an installment plan to pay back taxes negated an inference of willfulness. Defendant then requested that the district court give the jury a good faith instruction, an instruction the court had previously refused to give. The court again refused. The jury subsequently convicted defendant.

Defendant moved for a new trial on the ground, among others, that the district court's supplemental instruction during deliberations unfairly eliminated defendant's ability to pay defense, a defense which was proper under the *Poll* instruction initially given by the court. The district court agreed and ordered a new trial. The case was subsequently transferred to this Court for trial.

On retrial, the Court refused to give defendant's requested *Poll* instruction on the ground that it did

not adequately reflect the law or the evidence in the record. The Court did, however, instruct the jury on good faith over the government's objection. In particular, the Court instructed the jury that the government had the burden of proving that defendant did not have a good faith belief that he was complying with the tax laws, and that defendant's belief could be in good faith even if it was unreasonable.

DISCUSSION

Defendant's primary argument is that the Court erred in refusing to give the jury the *Poll* instruction. The Court did not do so because *Poll,* which was decided in 1975, no longer accurately reflects the law.

Poll involved charges similar to this case and was tried to the district court on stipulated facts. The court refused to consider evidence that the defendant's corporation "lacked the liquid resources to pay the full amounts due and that he intended to make up the deficiencies later." *Id.* at 331. The Ninth Circuit held that such evidence was relevant to "willfulness" and that to prove willfulness the government "must establish beyond a reasonable doubt that at the time payment was due the taxpayer possessed sufficient funds to enable him to meet his obligation or that lack of sufficient funds on such date was created by (or was the result of) a voluntary and intentional act without justification in view of all the financial circumstances of the taxpayer." *Id.* at 333. The court's holding was based on its belief that willfulness

requires an evil motive or improper purpose. *Id.* at 331-33; *see also Sorenson v. United States,* 521 F.2d 325, 328 n.3 (9th Cir. 1975) (noting that "[t]he *Poll* holding is applicable to the criminal test of willfulness which requires 'some element of evil motive and want of justification in view of all the financial circumstances of the taxpayer.'"); *United States v. Brennick,* 908 F.Supp. 1004, 1016 (D. Mass. 1995) (citation omitted) (explaining that *Poll* held that evidence of defendant's financial condition is relevant to "evil motive" or "improper purpose").

The following year, however, the Supreme Court ruled that "willfulness" in the context of the tax laws "simply means a voluntary, intentional violation of a known legal duty;" there is no requirement the government prove evil motive or improper purpose and want of justification. *United States v. Pomponio,* 429 U.S. 10, 12, (1976); *see also United States v. Powell,* 955 F.2d 1206, 1210 (9th Cir. 1992) ("'Willfulness' in the context of criminal tax cases is defined as a 'voluntary, intentional violation of a known legal duty'. . . . [It] need not include bad faith or bad purpose.") (citation omitted). Thus, the basis for *Poll's* creation of an additional element was effectively overruled by *Pomponio.*

Fifteen years later the Supreme Court expounded further on the definition of willfulness. In *Cheek v. United States,* 498 U.S. 192 (1991), the Supreme Court held that under the tax laws, unlike other laws, to prove willfulness the government has the burden of negating a defendant's claim of ignorance

of the law or a claim that because of a misunderstanding of the law, he had a good-faith belief that he was not violating any provision of the tax laws. *Id.* at 201-02. "This is so because one cannot be aware that the law imposes a duty upon him and yet be ignorant of it, misunderstand the law, or believe that the duty does not exist. In the end, the issue is whether, based on all the evidence, the Government has proved that the defendant was aware of the duty at issue, which cannot be true if the jury credits a good-faith misunderstanding and belief submission, whether or not the claimed belief or misunderstanding is objectively reasonable." *Id.* at 202.

Accordingly, in this case the government did not have the burden of proving that defendant had the "ability to pay" – whatever that may mean; instead, the government had the burden of proving that defendant knew he was violating the tax laws by not paying over the payroll taxes, even if defendant believed that he did not have the ability to pay, or believed that the only way he could pay was to not pay his nursing homes' operating expenses. This burden is greater than that imposed by *Poll* because even if the government proves that defendant had the ability to pay, it must still prove that defendant did not believe that he did not have the ability to pay and therefore was not in violation of the tax laws, or that he did not otherwise believe that his conduct was lawful. Moreover, the defendant's belief can be unreasonable and still negate the element of willfulness.

Thus, all the evidence admitted in the first trial was admissible in the second because it was relevant to defendant's good faith belief that he was not violating a known legal duty. And defendant was free to argue that he did not believe he was violating the tax laws because to pay the amounts owed he would have to close his nursing homes or at least not make full payroll. The verdict, however, demonstrates that the jury found beyond a reasonable doubt that defendant did not hold such belief. What defendant is arguing, in essence, is that even though the jury found that he did not believe that his financial condition excused his compliance with the tax laws, the Court should have instructed the jury that his financial condition could somehow excuse his compliance. Such a result does not comport with common sense.

Defendant's contention that the Court directed a verdict by instructing the jury that "[t]he tax laws do not permit an employer to choose to use the monies held in trust for the United States, for other purposes, such as to pay other business expenses" therefore fails. First, defendant does not cite any cases that suggest that this instruction is legally incorrect. As the government argued at trial, the tax laws do not allow a business to use payroll taxes held in trust for the United States as a personal bank account. *See United States v. Gilbert*, 266 F.3d 1180, 1185 (9th Cir. 2001) ("We agree with the Government that Gilbert's act of paying wages to his employees, instead of remitting withholding taxes to the IRS, shows that he

voluntarily and intentionally violated § 7202."). Second, the instruction did not direct a verdict because the government still had to prove beyond a reasonable doubt that defendant did not believe that he could use the monies held in trust to pay other expenses, at least in his particular circumstances.

CONCLUSION

For the reasons stated above, and the reasons stated orally during these proceedings, defendant's motion for judgment of acquittal or alternatively a new trial is DENIED. The Court will not further address the evidentiary issues raised by defendant.

IT IS SO ORDERED.

Dated: July 12, 2007 /s/ Charles Breyer
CHARLES R. BREYER
UNITED STATES
DISTRICT JUDGE

26 U.S.C. §§ 6651, 6656

§ 6651. Failure to file tax return or to pay tax.

(a) Addition to the tax. In case of failure –

(1) to file any return required under authority of subchapter A of chapter 61 [26 USCS §§ 6001 et seq.] (other than part III thereof [26 USCS §§ 6031 et seq.]), subchapter A of chapter 51 [26 USCS §§ 5001 et seq.] (relating to distilled spirits, wines, and beer), or of subchapter A of chapter 52 [26 USCS §§ 5701 et seq.] (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 [26 USCS §§ 5801 et seq.] (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate;

(2) to pay the amount shown as tax on any return specified in paragraph (1) on or before the date prescribed for payment of such tax (determined with regard to any extension of time for payment), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount shown as tax on such return 0.5

percent of the amount of such tax if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate; or

(3) to pay any amount in respect of any tax required to be shown on a return specified in paragraph (1) which is not so shown (including an assessment made pursuant to section 6213(b) [26 USCS § 6213(b)]) within 21 calendar days from the date of notice and demand therefor (10 business days if the amount for which such notice and demand is made equals or exceeds $ 100,000), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount of tax stated in such notice and demand 0.5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

In the case of a failure to file a return of tax imposed by chapter 1 [26 USCS §§ 1 et seq.] within 60 days of the date prescribed for filing of such return (determined with regard to any extensions of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, the addition to tax under paragraph (1) shall not be less than the lesser of $ 135 or 100 percent of the amount required to be shown as tax on such return.

(b) Penalty imposed on net amount due. For purposes of –

(1) subsection (a)(1), the amount of tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credit against the tax which may be claimed on the return,

(2) subsection (a)(2), the amount of tax shown on the return shall, for purposes of computing the addition for any month, be reduced by the amount of any part of the tax which is paid on or before the beginning of such month and by the amount of any credit against the tax which may be claimed on the return, and

(3) subsection (a)(3), the amount of tax stated in the notice and demand shall, for the purpose of computing the addition for any month, be reduced by the amount of any part of the tax which is paid before the beginning of such month.

(c) Limitations and special rule.

(1) Additions under more than one paragraph. With respect to any return, the amount of the addition under paragraph (1) of subsection (a) shall be reduced by the amount of the addition under paragraph (2) of subsection (a) for any month (or fraction thereof) to which an addition to tax applies under both paragraphs (1) and (2). In any case described in the last sentence of subsection (a), the

amount of the addition under paragraph (1) of subsection (a) shall not be reduced under the preceding sentence below the amount provided in such last sentence.

(2) Amount of tax shown more than amount required to be shown. If the amount required to be shown as tax on a return is less than the amount shown as tax on such return, subsections (a)(2) and (b)(2) shall be applied by substituting such lower amount.

(d) Increase in penalty for failure to pay tax in certain cases.

(1) In general. In the case of each month (or fraction thereof) beginning after the day described in paragraph (2) of this subsection, paragraphs (2) and (3) of subsection (a) shall be applied by substituting "1 percent" for "0.5 percent" each place it appears.

(2) Description. For purposes of paragraph (1), the day described in this paragraph is the earlier of –

(A) the day 10 days after the date on which notice is given under section 6331(d) [26 USCS § 6331(d)], or

(B) the day on which notice and demand for immediate payment is given under the last sentence of section 6331(a) [26 USCS § 6331(a)].

(e) Exception for estimated tax. This section shall not apply to any failure to pay any estimated tax

required to be paid by section 6654 or 6655 [26 USCS § 6654 or 6655].

(f) Increase in penalty for fraudulent failure to file. If any failure to file any return is fraudulent, paragraph (1) of subsection (a) shall be applied –

(1) by substituting "15 percent" for "5 percent" each place it appears, and

(2) by substituting "75 percent" for "25 percent".

(g) Treatment of returns prepared by Secretary under section 6020(b). In the case of any return made by the Secretary under section 6020(b) [26 USCS § 6020(b)] –

(1) such return shall be disregarded for purposes of determining the amount of the addition under paragraph (1) of subsection (a), but

(2) such return shall be treated as the return filed by the taxpayer for purposes of determining the amount of the addition under paragraphs (2) and (3) of subsection (a).

(h) Limitation on penalty on individual's failure to pay for months during period of installment agreement. In the case of an individual who files a return of tax on or before the due date for the return (including extensions), paragraphs (2) and (3) of subsection (a) shall each be applied by substituting "0.25" for "0.5" each place it appears for purposes of determining the addition to tax for any month during which an installment agreement under section 6159

[26 USCS § 6159] is in effect for the payment of such tax.

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§ 6656. Failure to make deposit of taxes.

(a) Underpayment of deposits. In the case of any failure by any person to deposit (as required by this title or by regulations of the Secretary under this title) on the date prescribed therefor any amount of tax imposed by this title in such government depository as is authorized under section 6302(c) [26 USCS § 6302(c)] to receive such deposit, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be imposed upon such person a penalty equal to the applicable percentage of the amount of the underpayment.

(b) Definitions. For purposes of subsection (a) –

(1) Applicable percentage.

(A) In general. Except as provided in subparagraph (B), the term "applicable percentage" means –

(i) 2 percent if the failure is for not more than 5 days,

(ii) 5 percent if the failure is for more than 5 days but not more than 15 days, and

(iii) 10 percent if the failure is for more than 15 days.

(B) Special rule. In any case where the tax is not deposited on or before the earlier of –

(i) the day 10 days after the date of the first delinquency notice to the taxpayer under section 6303 [26 USCS § 6303], or

(ii) the day on which notice and demand for immediate payment is given under section 6861 or 6862 [26 USCS § 6861 or 6862] or the last sentence of section 6331(a) [26 USCS § 6331],

the applicable percentage shall be 15 percent.

(2) Underpayment. The term "underpayment" means the excess of the amount of the tax required to be deposited over the amount, if any, thereof deposited on or before the date prescribed therefor.

(c) Exception for first-time depositors of employment taxes. The Secretary may waive the penalty imposed by subsection (a) on a person's inadvertent failure to deposit any employment tax if –

(1) such person meets the requirements referred to in section 7430(c)(4)(A)(ii) [26 USCS § 7430(c)(4)(A)(ii)],

(2) such failure –

(A) occurs during the first quarter that such person was required to deposit any employment tax; or

(B) if such person is required to change the frequency of deposits of any employment tax, relates to the first deposit to which such change applies, and

(3) the return of such tax was filed on or before the due date.

For purposes of this subsection, the term "employment taxes" means the taxes imposed by subtitle C [26 USCS §§ 3101 et seq.].

(d) Authority to abate penalty where deposit sent to Secretary. The Secretary may abate the penalty imposed by subsection (a) with respect to the first time a depositor is required to make a deposit if the amount required to be deposited is inadvertently sent to the Secretary instead of to the appropriate government depository.

(e) Designation of periods to which deposits apply.

(1) In general. A deposit made under this section shall be applied to the most recent period or periods within the specified tax period to which the deposit relates, unless the person making such deposit designates a different period or periods to which such deposit is to be applied.

(2) Time for making designation. A person may make a designation under paragraph (1) only during the 90-day period beginning on the date of a notice that a penalty under subsection (a) has been imposed for the specified tax period to which the deposit relates.

26 CFR 301.6651-1

§ 301.6651-1 Failure to file tax return or to pay tax.

(a) Addition to the tax – (1) Failure to file tax return. In case of failure to file a return required under authority of –

(i) Subchapter A, chapter 61 of the Code, relating to returns and records (other than sections 6015 and 6016 [26 USCS §§ 6015 and 6016], relating to declarations of estimated tax, and part III thereof, relating to information returns);

(ii) Subchapter A, chapter 51 of the Code, relating to distilled spirits, wines, and beer;

(iii) Subchapter A, chapter 52 of the Code, relating to cigars, cigarettes, and cigarette papers and tubes; or

(iv) Subchapter A, chapter 53 of the Code, relating to machine guns, destructive devices, and certain other firearms; and

The regulations thereunder, on or before the date prescribed for filing (determined with regard to any extension of time for such filing), there shall be added to the tax required to be shown on the return the amount specified below unless the failure to file the return within the prescribed time is shown to the satisfaction of the district director or the director of the service center to be due to reasonable cause and not to willful neglect. The amount to be added to the tax is 5 percent thereof if the failure is for not more

than 1 month, with an additional 5 percent for each additional month or fraction thereof during which the failure continues, but not to exceed 25 percent in the aggregate. The amount of any addition under this subparagraph shall be reduced by the amount of the addition under subparagraph (2) of this paragraph for any month to which an addition to tax applies under both subparagraphs (1) and (2) of this paragraph (a).

(2) Failure to pay tax shown on return. In case of failure to pay the amount shown as tax on any return (required to be filed after December 31, 1969, without regard to any extension of time for filing thereof) specified in subparagraph (1) of this paragraph (a), on or before the date prescribed for payment of such tax (determined with regard to any extension of time for payment), there shall be added to the tax shown on the return the amount specified below unless the failure to pay the tax within the prescribed time is shown to the satisfaction of the district director, or, as provided in paragraph (a) of this section, the Assistant Regional Commissioner (Alcohol, Tobacco and Firearms), the director of the service center, to be due to reasonable cause and not to willful neglect. Except as provided in paragraph (a)(4) of this section, the amount to be added to the tax is 0.5 percent of the amount of tax shown on the return if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which the failure continues, but not to exceed 25 percent in the aggregate.

(3) Failure to pay tax not shown on return. In the case of failure to pay any amount of any tax required to be shown on a return specified in paragraph (a)(1) of this section that is not so shown (including an assessment made pursuant to section 6213(b) [26 USCS § 6213(b)]) within 21 calendar days from the date of the notice and demand (10 business days if the amount assessed and shown on the notice and demand equals or exceeds $ 100,000) with respect to any notice and demand made after December 31, 1996, there will be added to the amount stated in the notice and demand the amount specified below unless the failure to pay the tax within the prescribed time is shown to the satisfaction of the district director or the director of the service center to be due to reasonable cause and not to willful neglect. Except as provided in paragraph (a)(4) of this section, the amount to be added to the tax is 0.5 percent of the amount stated in the notice and demand if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which the failure continues, but not to exceed 25 percent in the aggregate. For purposes of this paragraph (a)(3), see § 301.6601-1(f)(5) for the definition of calendar day and business day.

(4) Reduction of failure to pay penalty during the period an installment agreement is in effect – (i) In general. In the case of a return filed by an individual on or before the due date for the return (including extensions) –

(A) The amount added to tax for a month or fraction thereof is determined by using 0.25 percent instead of 0.5 percent under paragraph (a)(2) of this section if at any time during the month an installment agreement under section 6159 [26 USCS § 6159] is in effect for the payment of such tax; and

(B) The amount added to tax for a month or fraction thereof is determined by using 0.25 percent instead of 0.5 percent under paragraph (a)(3) of this section if at any time during the month an installment agreement under section 6159 [26 USCS § 6159] is in effect for the payment of such tax.

(ii) Effective date. This paragraph (a)(4) applies for purposes of determining additions to tax for months beginning after December 31, 1999.

(b) Month defined. (1) If the date prescribed for filing the return or paying tax is the last day of a calendar month, each succeeding calendar month or fraction thereof during which the failure to file or pay tax continues shall constitute a month for purposes of section 6651 [26 USCS § 6651].

(2) If the date prescribed for filing the return or paying tax is a date other than the last day of a calendar month, the period which terminates with the date numerically corresponding thereto in the succeeding calendar month and each such successive period shall constitute a month for purposes of section 6651 [26 USCS § 6651]. If, in the month of February, there is no date corresponding to the date prescribed for filing the return or paying tax, the

period from such date in January through the last day of February shall constitute a month for purposes of section 6651 [26 USCS § 6651]. Thus, if a return is due on January 30, the first month shall end on February 28 (or 29 if a leap year), and the succeeding months shall end on March 30, April 30, etc.

(3) If a return is not timely filed or tax is not timely paid, the fact that the date prescribed for filing the return or paying tax, or the corresponding date in any succeeding calendar month, falls on a Saturday, Sunday, or a legal holiday is immaterial in determining the number of months for which the addition to the tax under section 6651 [26 USCS § 6651] applies.

(c) Showing of reasonable cause.

(1) Except as provided in subparagraphs (3) and (4) of this paragraph (b), a taxpayer who wishes to avoid the addition to the tax for failure to file a tax return or pay tax must make an affirmative showing of all facts alleged as a reasonable cause for his failure to file such return or pay such tax on time in the form of a written statement containing a declaration that it is made under penalties of perjury. Such statement should be filed with the district director or the director of the service center with whom the return is required to be filed; Provided, That where special tax returns of liquor dealers are delivered to an alcohol, tobacco and firearms officer working under the supervision of the Regional Director, Bureau of Alcohol, Tobacco and Firearms, such statement may be delivered with the return. If the district director,

the director of the service center, or, where applicable, the Regional Director, Bureau of Alcohol, Tobacco and Firearms, determines that the delinquency was due to a reasonable cause and not to willful neglect, the addition to the tax will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause. A failure to pay will be considered to be due to reasonable cause to the extent that the taxpayer has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship (as described in § 1.6161-1(b) of this chapter) if he paid on the due date. In determining whether the taxpayer was unable to pay the tax in spite of the exercise of ordinary business care and prudence in providing for payment of his tax liability, consideration will be given to all the facts and circumstances of the taxpayer's financial situation, including the amount and nature of the taxpayer's expenditures in light of the income (or other amounts) he could, at the time of such expenditures, reasonably expect to receive prior to the date prescribed for the payment of the tax. Thus, for example, a taxpayer who incurs lavish or extravagant living expenses in an amount such that the remainder of his assets and anticipated income will be insufficient to pay his tax, has not exercised ordinary business care and prudence in providing for the payment of his tax liability. Further, a taxpayer who invests funds in speculative or illiquid assets has

not exercised ordinary business care and prudence in providing for the payment of his tax liability unless, at the time of the investment, the remainder of the taxpayer's assets and estimated income will be sufficient to pay his tax or it can be reasonably foreseen that the speculative or illiquid investment made by the taxpayer can be utilized (by sale or as security for a loan) to realize sufficient funds to satisfy the tax liability. A taxpayer will be considered to have exercised ordinary business care and prudence if he made reasonable efforts to conserve sufficient assets in marketable form to satisfy his tax liability and nevertheless was unable to pay all or a portion of the tax when it became due.

(2) In determining if the taxpayer exercised ordinary business care and prudence in providing for the payment of his tax liability, consideration will be given to the nature of the tax which the taxpayer has failed to pay. Thus, for example, facts and circumstances which, because of the taxpayer's efforts to conserve assets in marketable form, may constitute reasonable cause for nonpayment of income taxes may not constitute reasonable cause for failure to pay over taxes described in section 7501 [26 USCS § 7501] that are collected or withheld from any other person.

(3) If, for a taxable year ending on or after December 31, 1995, an individual taxpayer satisfies the requirement of § 1.6081-4(a) of this chapter (relating to automatic extension of time for filing an individual income tax return), reasonable cause will

be presumed, for the period of the extension of time to file, with respect to any underpayment of tax if –

(i) The excess of the amount of tax shown on the individual income tax return over the amount of tax paid on or before the regular due date of the return (by virtue of tax withheld by the employer, estimated tax payments, and any payment with an application for extension of time to file pursuant to § 1.6081-4 of this chapter) is no greater than 10 percent of the amount of tax shown on the individual income tax return; and

(ii) Any balance due shown on the individual income tax return is remitted with the return.

(4) If, for a taxable year ending on or after December 31, 1972, a corporate taxpayer satisfies the requirements of § 1.6081-3(a) (relating to an automatic extension of time for filing a corporation income tax return), reasonable cause shall be presumed, for the period of the extension of time to file, with respect to any underpayment of tax if –

(i) The amount of tax (determined without regard to any prepayment thereof) shown on Form 7004, or the amount of tax paid on or before the regular due date of the return, is at least 90 percent of the amount of tax shown on the taxpayer's Form 1120, and

(ii) Any balance due shown on the Form 1120 is paid on, or before the due date of the return, including any extensions of time for filing.

(d) Penalty imposed on net amount due – (1) Credits against the tax. The amount of tax required to be shown on the return for purposes of section 6651(a)(1) [26 USCS § 6651(a)(1)] and the amount shown as tax on the return for purposes of section 6651(a)(2) [26 USCS § 6651(a)(2)] shall be reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credit against the tax which may be claimed on the return.

(2) Partial payments. (i) The amount of tax required to be shown on the return for purposes of section 6651(a)(2) [26 USCS § 6651(a)(2)] shall, for the purpose of computing the addition for any month, be reduced by the amount of any part of the tax which is paid after the date prescribed for payment and on or before the first day of such month.

(ii) The amount of tax stated in the notice and demand for purposes of section 6651(a)(3) [26 USCS § 6651(a)(3)] shall, for the purpose of computing the addition for any month, be reduced by the amount of any part of the tax which is paid before the first day of such month.

(e) No addition to tax if fraud penalty assessed. No addition to the tax under section 6651 [26 USCS § 6651] shall be assessed with respect to an underpayment of tax if a 50-percent addition to the tax for fraud is assessed with respect to the same underpayment under section 6653(b) [26 USCS § 6653(b)]. See section 6653(d) [26 USCS § 6653(d)].

(f) Examples. The provisions of this section may be illustrated by the following examples:

Example 1. (a) Under section 6072(a) [26 USCS § 6072(a)], income tax returns of individuals on a calendar year basis must be filed on or before the 15th day of April following the close of the calendar year. Assume an individual filed his income tax return for the calendar year 1969 on July 20, 1970, and the failure to file on or before the prescribed date is not due to reasonable cause. The tax shown on the return is $ 800 and a deficiency of $ 200 is subsequently assessed, making the tax required to be shown on the return, $ 1,000. Of this amount, $ 300 has been paid by withholding from wages and $ 400 has been paid as estimated tax. The balance due as shown on the return of $ 100 ($ 800 shown as tax on the return less $ 700 previously paid) is paid on August 21, 1970. The failure to pay on or before the prescribed date is not due to reasonable cause. There will be imposed, in addition to interest, an additional amount under section 6651(a)(2) [26 USCS § 6651(a)(2)] of $ 2.50, which is 2.5 percent (2% for the 4 months from April 16 through August 15, and 0.5% for the fractional part of the month from August 16 through August 21) of the net amount due as shown on the return of $ 100 ($ 800 shown on the return less $ 700 paid on or before April 15). There will also be imposed an additional amount under section 6651(a)(1) [26 USCS § 6651(a)(1)] of $ 58, determined as follows:

20 percent (5% per month for the 3 months from April 16 through July 15 and 5% for

the fractional part of the month from July 16 through July 20) of the net amount due of $300 ($1,000 required to be shown on the return less $700 paid on or before April 15)	$ 60
Reduced by the amount of the addition imposed under section 6651(a)(2) for those months 2	
Addition to tax under section 6651(a)(1)	$ 50

(b) A notice and demand for the $ 200 deficiency is issued on January 8, 1971, but the taxpayer does not pay the deficiency until December 23, 1971. In addition to interest there will be imposed an additional amount under section 6651(a)(3) [26 USCS § 6651(a)(3)] of $ 10, determined as follows:

Addition computed without regard to limitation:	
6 percent (5 1/2% for the 11 months from January 19, 1971 through December 18, 1971, and 0.5% for the fractional part of the month from December 19 through December 23) of the amount stated in the notice and demand ($200)	$ 12
Limitation on addition:	
25 percent of the amount stated in the notice and demand ($ 200) Reduced by the part of the addition under section 6651(a)(1) for failure to file attributable to the $200 deficiency (20% of $200)	$ 50 $ 40
Maximum amount of the addition under section 6651(a)(3)	$ 10

Example 2. An individual files his income tax return for the calendar year 1969 on December 2, 1970, and such delinquency is not due to reasonable cause. The balance due, as shown on the return, of $ 500 is paid when the return is filed on December 2, 1970. In addition to interest and the addition for failure to pay under section 6651(a)(2) [26 USCS § 6651(a)(2)] of $ 20 (8 months at 0.5% per month, 4%), there will also be imposed an additional amount under section 6651(a)(1) [26 USCS § 6651(a)(1)] of $ 112.50, determined as follows:

Penalty at 5 percent for maximum of 5 months, 25 percent of $ 500. Less reduction for the amount of the addition under section 6651(a)(2):	$ 125.00
Amount imposed under section 6651(a)(2) for the months in which there is also an addition for failure to file – 2 1/2 percent for the 5 months April 16 through September 15 of the net amount due ($ 500) $112.50	
Addition to tax under section 6651(a)(1)	$ 112.50

(g) Treatment of returns prepared by the Secretary – (1) In general. A return prepared by the Secretary under section 6020(b) [26 USCS § 6020(b)] will be disregarded for purposes of determining the amount of the addition to tax for failure to file any return pursuant to paragraph (a)(1) of this section. However, the return prepared by the Secretary will be treated as a return filed by the taxpayer for purposes of

determining the amount of the addition to tax for failure to pay the tax shown on any return and for failure to pay the tax required to be shown on a return that is not so shown pursuant to paragraphs (a)(2) and (3) of this section, respectively.

(2) Effective date. This paragraph (g) applies to returns the due date for which (determined without regard to extensions) is after July 30, 1996.